Entered on Docket
June 19, 2006
GLORIA L. FRANKLIN, CLERK
U.S BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

NOT FOR PUBLICATION

Signed: June 19, 2006

RANDALL J. NEWSOME
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

OAKLAND DIVISION

In re:

READ-RITE CORP.,

Debtor(s)/

Case Number: 03-43576RN

Chapter: 7

FINDINGS OF FACT, OPINION AND CONCLUSIONS OF LAW REGARDING OBJECTION OF THE CHAPTER 7 TRUSTEE AND WESTERN DIGITAL CORPORATION TO THE §365(n) ELECTION FILED BY INTERNATIONAL BUSINESS MACHINES

FINDINGS OF FACT

This chapter 7 case is before the court pursuant to the objection of Western Digital Corporation (hereafter "Western Digital") to the election by International Business Machines (hereafter "IBM"), on behalf of itself and Hitachi, Limited (hereafter "Hitachi Ltd.") to retain intellectual property rights under 11 U.S.C. §365(n). This election originally was asserted as to the chapter 7 trustee of Read-Rite Corp. (hereafter "Read-Rite") estate. However, pursuant to a compromise reached with Western Digital, the purchaser of virtually all assets of Read-Rite, Western Digital agreed to serve as "attorney in fact" for the trustee in this dispute. A trial on this matter was conducted on April 3 and 4, 2006. At the conclusion of the trial, the court issued a tentative ruling. That tentative ruling is hereby vacated and superceded in its entirety by these findings and conclusions.

This dispute evolved out of a nonexclusive cross-licensing agreement of intellectual property between Read-Rite and IBM entered into on January 1, 1997. (Exhibit 1). In mid-2003 IBM agreed to sell its hard disk drive business to Hitachi Ltd. for some $2 billion. (Trial Transcript ("TT") p. 82).

In furtherance of that agreement, IBM set up a wholly-owned subsidiary in the Netherlands known as Mariana HDD B.V. (hereafter "Mariana"), to which it transferred its disk drive business. (Stipulation of Hitachi, IBM and Western Digital, Case No. 03-43576-RN-7, Docket No. 1364, hereafter the "Stipulation"; Exhibit N). On October 30, 2002, IBM wrote a letter to Read-Rite requesting a license for Mariana pursuant to § 2.10 of the cross-licensing agreement, which spells out the parties' rights to a license upon the transfer of a product line. (Exhibit 4.) A proposed draft agreement was attached. Section 8.10 of that agreement stated in pertinent part as follows:

> This agreement shall not be binding upon the parties until it has been signed herein below by or on behalf of each party. . . .

On December 23, 2002, IBM again sought Read-Rite's approval of a license for Mariana. (Exhibit 5). The sale to Hitachi Ltd. closed on December 31, 2002, at which time Mariana was transformed into Hitachi Global Storage Technologies Netherlands, B.V. (hereafter "Hitachi Netherlands"). Hitachi Netherlands became a holding company for a number of subsidiaries, including an operating subsidiary known as Hitachi Global Storage Technologies, Inc. The parties agree that notice to Hitachi Global Storage Technologies, Inc. constituted notice to Hitachi Netherlands. (Hearing Transcript, February 28, 2006, Docket No. 1346, p. 6-7). Everyone also agrees that this transaction met the conditions of § 2.10 of the cross-licensing agreement. (Stipulation, ¶ 2).

On February 28, 2003 IBM renewed its request that Read Rite enter into a license with Hitachi Netherlands. (Exhibit 8). Read-Rite finally responded to these requests on March 18, 2003 by way of a letter from Colin R. Campbell, Read-Rite's general counsel. That letter sought a number of changes to IBM's draft agreement, including a demand that Hitachi Ltd. grant Read-Rite a cross license. (Exhibit 11). By letter dated April 28, 2003, IBM rejected all of these changes, and again requested that Read-Rite sign the attached agreement. That agreement modified § 8.10 to recognize the license to Mariana, but retained the requirement that the agreement be signed as a prerequisite to its effectiveness. (Exhibit 17). On May 12, 2003 Colin Campbell called Robert Tassinari, IBM senior counsel of intellectual property and licensing, and left a message indicating that Read-Rite would accede to IBM's terms if the license was with Hitachi Ltd. rather than Hitachi Netherlands. (Exhibit 18).

After discussing this proposal with Hitachi Ltd., Tassinari relayed IBM's acceptance of Read-Rite's proposal, and submitted a black-lined version of the IBM draft agreement incorporating the change. Modified § 8.10 was again incorporated into this draft. (Exhibits 20 and 21). Although this acceptance letter was dated June 13, 2003, it was not sent until June 16. (TT p. 61). On June 16 and again on the 17th, Tassinari talked to Campbell, who indicated that he would have the agreement signed. In the meantime, at 4:19 PM on June 17, Read-Rite filed its chapter 7 petition. On June 18, Campbell informed Tassinari by e-mail that because of the bankruptcy, no one at Read-Rite could or would sign the agreement. (Exhibit 22).

Tassinari then attempted to have the chapter 7 trustee sign the agreement, to no avail. (Exhibit 24). In a letter dated July 15, 2003, IBM asserted that "with or without the formality of the trustee's signature on the Agreement, the Read-Rite patents identified in the Agreement are irrevocably encumbered with a license to Hitachi." In the next paragraph of the letter, however, IBM urges the trustee to "accept. . .the agreement." (Exhibit 37).

In July of 2003, a bidding war for Read-Rite's assets broke out between Hitachi, Western Digital and others. On July 8, Hitachi Global Storage Technologies, Inc., through its attorneys, Morrison & Foerster LLP, filed a "Notice of Appearance and Request for Service of All Pleadings and Documents." (Docket No. 63). Western Digital ultimately was the winning bidder, and on July 25, 2003 the sale of virtually all of Read-Rite's assets to Western Digital was approved. (Docket No. 151). Certain executory contracts were rejected in conjunction with that sale, one of which involved Hitachi Metals Ltd. On July 23, 2003, Hitachi Ltd. was sent this "important legal notice" at the address listed at § 7.1 of IBM's draft licensing agreement between Read-Rite and Hitachi Ltd. (Exhibit LL).

On July 28, 2003, IBM was informed that Western Digital acquired Read-Rite's patents. (Exhibit 44). In a letter to Western Digital dated September 23, 2003, IBM again asserted that Hitachi Ltd. ". . . enjoys the license and other rights set forth in the Read-Rite-Hitachi Agreement," even though that agreement was never signed. (Exhibit 45). On November 26, 2003 Western Digital responded with the assertion that ". . . Hitachi Ltd. did not have a license with Read-Rite at the time of the Read-Rite bankruptcy filing." (Exhibit 50).

Although Hitachi Ltd. was not listed as a recipient of any of the communications between IBM and Read-Rite during the period from May 12 to July 15, 2003, the parties have stipulated that IBM sent by facsimile Exhibits 18, 20, 22 and 37 (also identified as Exhibits GG through KK), as well as other correspondence, to responsible persons at Hitachi Ltd. in Japan. (TT p. 102). Thus, no later than July 15, 2003, or soon thereafter, Hitachi Ltd. was aware that IBM had asserted that Hitachi Ltd. had a license from Read-Rite, even though neither Read-Rite nor Hitachi Ltd. nor the chapter 7 trustee had signed the agreement. It is reasonable to assume that Hitachi Ltd. was also forwarded a copy of IBM's September 23 letter to Western Digital and Western Digital's November 26, 2003 response in which it rejected Hitachi's license claim.

On November 14, 2003, the chapter 7 trustee filed and served a motion seeking among other things to establish procedures for asserting rights under 11 U.S.C. § 365(n). Although the list of contracts Read-Rite sought to reject did not include the alleged license between Read-Rite and Hitachi Ltd., it did list a number of other agreements between Read-Rite and Hitachi entities, including Hitachi Ltd. (Exhibit 47). Hitachi Ltd. was served with notice of this motion at numerous addresses in Japan and the United States. More importantly, consistent with their July 8, 2003 request, Morrison & Foerster lawyers Adam Lewis in San Francisco and Larren Nashelsky in New York City, representing Hitachi Global Storage Technologies, Inc., were sent notice of the motion. Hitachi Ltd. does not dispute that it received notice of the motion. (TT p. 35). However, as the court determined on the first day of the trial on this matter, IBM was sent notice at an address in Thornwood, New York that they had long since vacated, and thus did not receive notice of this motion. (Exhibit 49).

On January 12, 2004 the court approved rejection of the executory contracts listed in the November 14, 2003 motion, and set February 1, 2004 as the bar date to assert rights under § 365(n). (Exhibit 52). The alleged license between Hitachi Ltd. and Read-Rite again was not listed as among the contracts being assumed or rejected, but it bears repeating that Western Digital did not believe that such a license existed. Hitachi and its lawyers, Morrison & Foerster, were served with this order at the same addresses listed in the proof of service for the November 14, 2003 motion. (Exhibit 53).

Neither Hitachi Ltd. nor IBM filed anything before the bar date. However, it wasn't until

February 18, 2005 that IBM learned of the January 12, 2004 order. This information was obtained from an attorney at Morrison & Foerster. (TT 92-93; 96-97). On February 22, 2005, Tassinari filed a declaration in which IBM purported to exercise its § 365(n) rights as to its licensing agreement with Read-Rite, and also purported to preserve the license rights of Hitachi Global Storage Technologies, Inc. in connection with the sale of its disk drive business pursuant to §2.10 of the agreement. (Exhibit 56).

OPINION AND CONCLUSIONS OF LAW

The rights of the parties before the court begin and end with the resolution of one simple issue: did Read-Rite and Hitachi Ltd. enter into a binding licensing agreement prior to Read-Rite's June 17, 2003 chapter 7 petition? Upon further reflection and study, the court concludes that they did not and could not without a signed agreement. Under the laws of New York, which the parties agree are applicable here, where the parties have expressly conditioned the effectiveness of a contract upon its formal execution, their intentions must be honored, and "no amount of negotiation or oral agreement to specific terms will result in the formation of a binding contract. . . . Because of this freedom to determine the exact point at which an agreement becomes binding, a party can negotiate candidly, secure in the knowledge that he will not be bound until execution of what both parties consider to be the final document." *Winston v. Mediafare Entertainment Corporation*, 777 F.2d 78, 80 (2d Cir. 1986); *see also Ciaramella v. Reader's Digest Association, Inc.*, 131 F.3d 320 (2d Cir. 1997); *R.G. Group, Inc. v. Horn & Hardert Company*, 751 F.2d 69 (2d Cir. 1984); *Reprosystem, B.V. v. SCM Corporation*, 727 F.2d 257 (2d Cir. 1984); *Naturopathic Laboratories International, Inc. v. SSL Americas, Inc.*, 18 App. Div. 3d 404, 795 N.Y.S.2d 580 (2005). Applying the four-part test set forth in *Winston* to the facts presented here, I find by more than a preponderance of the evidence that the parties did not intend to be bound absent the execution of a written document.

First, § 8.10 was included in each of the many drafts of the Hitachi license, and it unequivocally required the parties' signatures as a condition to the agreement being binding. The fact that Colin Campbell from Read-Rite sought to have someone from his side sign the agreement, and that IBM doggedly sought to have Read-Rite and then the chapter 7 trustee sign the agreement, evidences a clear understanding that this act was an essential prerequisite to the document's effectiveness. There is no

evidence that either party by their words or conduct ever waived this prerequisite; all of the evidence is to the contrary.

Second, there is no evidence of partial performance of the contract. Nothing was presented to indicate that Read-Rite, Western Digital or Hitachi Ltd. ever engaged in any conduct to carry out the terms of the unexecuted agreement.

Third, while there does not appear to have been anything left to negotiate as of June 16, 2003, Read-Rite's bankruptcy on June 17 might well have raised a whole new set of issues that needed to be incorporated into subsequent drafts of the agreement.

Finally, it is beyond debate that agreements of this kind are ordinarily written and executed. The contract negotiated between Read-Rite and Hitachi was not only complex, but was between two competitors and customers in the field of information technology and implicated literally millions, if not billions, of dollars in assets. Since a nonexclusive patent license is at its core simply an agreement not to sue the licensee for patent infringement, the importance of executing a written document reflecting this arrangement cannot be overestimated. What was true of the settlement agreement in *Winston* is doubly true as between Read-Rite and Hitachi Ltd.:

> Where, as here, the parties are adversaries and the purpose of the agreement is to forestall litigation, prudence strongly suggests that their agreement be written in order to make it readily enforceable, and to avoid still further litigation.
> 777 F.2d at 83.

Accordingly, since the evidence meets all four of the *Winston* factors, and since it is apparent that the parties did not intend to be bound until the agreement was signed, I conclude that Hitachi Ltd. and Read-Rite were never bound by the licensing agreement here in question.

Even if the agreement had been executed in accordance with its terms and had become binding on the parties, I find that Hitachi Ltd. relinquished its rights under the agreement and failed to exercise its § 365(n) rights in a timely fashion. It is beyond a reasonable doubt that Hitachi Ltd. was fully apprised of its rights and of the trustee's motions affecting its rights. Since it knew that Western Digital had bought Read-Rite's intellectual property, including the IBM cross-license, and that Western Digital had taken the position that Hitachi Ltd. had no license from Read-Rite, it certainly could not have been

surprised to find that its unexecuted license with Read-Rite was not on the schedule of licenses that the trustee on behalf of Western Digital wished to assume or reject. Both Hitachi Ltd. and its lawyers had timely received all of the notices and orders concerning rejection of contracts and the consequences for not pursuing any § 365(n) rights they held. Given the uncertainty surrounding its license rights as to Read-Rite, and the notices that both its lawyers received and the company itself received regarding other contracts it had with Read-Rite, the court finds that it had ample inquiry notice that required it to do something to protect whatever rights the unexecuted license afforded it. By not doing something by the February 1, 2004 bar date, Hitachi Ltd. relinquished any rights it had under the unexecuted agreement and § 365(n).

At trial, Hitachi Ltd. was given the opportunity to present evidence that its failure to meet the time limits for asserting its rights under the purported license with Read-Rite and under § 365(n) was due to excusable neglect, and thus could be remedied under Bankruptcy Rule 9006(b)(1). Absolutely no evidence was presented from which it could be found that Hitachi Ltd. meets the four-part test for finding excusable neglect enunciated in *Pioneer Inv. Services v. Brunswick Associates,* 507 U.S. 380, 113 S.Ct. 1489, 1498 (1993), or the six-part test referenced in *Kyle v. Campbell Soup Company*, 28 F.3d 928 (9th Cir. 1994). Indeed, Hitachi Ltd.'s failure to act when it had plenty of notice of its need to remains largely a mystery. Even if it thought it had a license with Read-Rite as of the date of bankruptcy, it is unfathomable why it did nothing to assert or protect those rights in a timely way. The only explanation offered for this inaction is found in Exhibit O. In a March 10, 2005 letter to Raymond Bukaty, general counsel for Western Digital, Hisao Yamasaki, general manager for intellectual property licensing for Hitachi Ltd., states in pertinent part as follows:

> As said in our meeting, our earlier independent analysis of the Read-Rite patents did not indicate to us that there were any of importance to our designs,. . . .

While Hitachi Ltd.'s counsel has labored mightily to put a different spin on this statement than its plain meaning would suggest, the court finds that it can only be interpreted as an expression of complete disinterest in the Read-Rite patents, and thus of any license to use those patents. This being the only evidence on point, the court not only finds no excusable neglect, but finds that Hitachi purposefully and

intentionally did not respond to the notices it obviously received.

Accordingly, for the reasons stated above, the court finds that there was no binding agreement between Read-Rite and Hitachi Ltd., and that even if there were, Hitachi Ltd. has failed to prove excusable neglect in not making a timely election of rights under § 365(n).

IT IS SO ORDERED.

END OF ORDER

COURT SERVICE LIST

MORRISON & FOERSTER, LLP
ADAM A LEWIS, ESQ.
425 Market Street
San Francisco, California 94105

SHEPPARD, MULLIN, RICHTER & HAMPTON, LLP
TERRENCE V. PONSFORD, ESQ.
Four Embarcadero Center, 17th Floor
San Francisco, California 94111

OPPENHEIMER, WOLFF & DONNELLY, LLP
STEVEN W. MEYER, ESQ.
Plaza VII, Suite 3300
45 South Seventh Street
Minneapolis, Minnesota 55402

O'MELVENY & MYERS, LLP
SUZZANNE S. UHLAND, ESQ.
AUSTIN K. BARRON, ESQ.
Embarcadero Center West
275 Battery Street
San Francisco, California 94111

IRELL & MANELLA, LLP
BRUCE A. WESSEL, ESQ.
DAVID A. RYAN, ESQ.
1800 Avenue of the Stars,
Suite 900
Los Angeles, California 90067

PINNACLE LAW GROUP, LLP
JEREMY KATZ, ESQ.
425 California Street, Suite 1800
San Francisco, California 94104

OFFICE OF THE U.S. TRUSTEE
1301 Clay St. #690N
Oakland, CA 94612